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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1949.

No. 776

HARRY V. VICTOR and ELLA S. VICTOR, his wife, EDWARD V. TRAINOR, JOHN C. KRUEGER, EMILIE B. KRUEGER and JOSEPH RECUPIDO,

Petitioners,

vs.

HERBERT HILLEBRECHT, JAMES V. BREMNER and WALTER A. WADE, as Trust Managers, and HERBERT HILLEBRECHT, individually, and the TRUST COMPANY OF CHICAGO, not individually but as Liquidation Trustee under Trust No. 995,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF ILLINOIS AND BRIEF IN SUPPORT THEREOF.

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INDEX.

PAGE

Petition:

Summary of the Matter Involved 2

The Questions Involved 5

Reasons for the Granting of the Writ 6

Prayer for Relief 7

Brief:

Jurisdiction Invoked 9

Opinions Below 10

A Statement of the case 10

Argument 17-52

Conclusion 52

Summary of Argument:

I.

A Federal Question Under Section 77-B of the Bankruptcy Act Is Clearly Involved in This Case, and This Court Has Jurisdiction to Issue the Writ 17

II.

The Decision of the Supreme Court of Illinois Is in Conflict with Federal Law on the Rights, Duties and Obligations of Fiduciaries Appointed Under Section 77-B of the Bankruptcy Act 23

(a) Fiduciaries may not deal in the securities of a reorganized company under §77-B or Chapter X of the Bankruptcy Act, and the sanctioning of the acts of the trustees in the instant case is contrary to Federal law which is controlling under the Liquidation Trust which was created by the Federal Court..... 24

(1) The Trust Managers acquired their interest in the Trust Property in fraud and breach of trust as held by the Appellate Court, and the views of the Supreme Court to the contrary are not in conformity with the views of the Federal courts..... 24

(b) The Appellate Court properly followed Federal law when it held that the Trust Managers were guilty of a breach of trust in dealing with the subject matter of the Trust for their personal gain whereby they placed themselves in a conflicting position, and the reversal of its judgment by the Supreme Court of Illinois is in conflict with the views of this court..... 29

III.

The Determination in the Instant Case, Contrary to the Opinion of the Intermediate Appellate Court, That Respondents Were Not Bound to Submit the Offer to the Beneficiaries, Notwithstanding the Fact That They, Themselves, Obtained the Appraisal That the Value of the Trust Property Did Not Exceed the Amount of the Bid, Constitutes a Denial of the Rights of the Beneficiaries Under the Federal Statute 43

CASES CITED.

American Ins. Co. v. Avan Park, 311 U. S. 138 29

Awotin v. Atlas Exchange National Bank, 295 U.S. 209 22

Brickerhoff Faris Co. v. Hill, 281 U. S. 673 23

Brown v. McLanahan, 148 F 2d. 703 46

Buder v. Fiske, 174 F (2) 260 37

City Bank Farmers Trust Co. v. Cannon 291 N. Y. 125 39

Cities Inc. v. Prudential Co., 322 U. S. 408 38

Matter of Lewisohn, 294 N. Y. 596 39

First Nat'l Bank v. Bryn Mawr Bldg. Corporation, 365 Ill. 409 47

Frost & Co. v. Mines Corp., 312 U. S. 38 22

Hackner v. Morgan, 117 F (2) 95 43

Halvering v. Stewart, 317 U. S. 154, 165 47

Hughes v. S.E.C., 174 F (2) 969 38

Magruder v. Drury, 235 U. S. 106 30

Matter of Lewisohn, 294 N. Y. 596 30

Matter of Midland United Co., 159 F (2) 340 29

Morris v. The Broadview, Inc., 328 Ill. App. 267 42

Oeau Claire National Bank, 204 U. S. 522 19

Prudence Corporation v. Giest, 316 U. S. 89 23

Rollin v. Halvering, 92 F (2) 390, 393 47

Rottenberg v. Seifried, 322 Ill. App. 701 43

Sanders v. Shaw, 244 U. S. 317 23

Seabury Receiver v. Greene, 294 U. S. 165 22

Siegleman v. Steinberg, 5 Cal. (2) 674, 56 P (2) 202 40

Smolowe v. Delendo Corporation, 136 F 2d. 231 36

Solo Electric Co. v. Jefferson Co., 317 U. S. 173 23

St Louis, I. M. T. & S. Ry. Co. v. Starbird, 243 U.S. 592 19

Stix v. Commissioner, 152 F (2) 562, 563 47

Swope v. Leffingwell, 105 U. S. 3 19

Victor v. Hillebrecht, 339 Ill. App. 254, 90 N. E. (2) 270 10

Victor v. Hillebrecht, 405 Ill. 264, 90 N. E. (2) 751 10

Wislon v. Cooke, 327 U. S. 474 23

Wootten v. Wootten, 151 F (2) 147, 159 F (2) 567, 331 U. S. 835 ..... 33, 35

Woods v. City National Bank & Trust Co., 312 U. S. 262 30

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Bogert on Trusts §485 41

Bogert on Trusts §493 29

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Respondents.

PETITION FOR WRIT OF CERTIORARI.

Petitioners, the plaintiffs in the above entitled cause, petition this court for the issuance of a writ of certiorari to the Supreme Court of Illinois to review its judgment reversing the judgment of the Appellate Court of Illinois, to the end that the judgment be reversed with directions to affirm the judgment of the Appellate Court of Illinois.

Summary of the Matter Involved.

On July 9, 1935 a plan of reorganization pursuant to §77-B of the Bankruptcy Act, as amended, was approved by the District Court for the Northern District of Illinois. Under the terms of the plan and decree of the court the title to the premises then owned by the Debtor, 7000 South Shore Drive Building Corporation, was conveyed to a Trustee under a Liquidation Trust Agreement wherein the respondents, James V. Bremner, Herbert Hillebrecht, and Walter A. Wade, were appointed by the court as Trust Managers, and the actions of the Trustee were controlled by the directions of the Trust Managers. Under the terms of the plan, the first mortgage bonds in the aggregate sum of $1,350,000, were exchanged for beneficial interests or units issued by the Trust, and there were issued 14,439 trust units. The Trust was to terminate in fifteen years. If not sooner terminated under the provisions therein contained and the proceeds distributed, then upon the termination of the trust, a corporation is to be formed and the trust units exchanged for the stock of the corporation. The Trust Property consists of a hotel apartment building containing 148 furnished apartments and 31 unfurnished apartments. The Trustees were authorized to sell the Trust Property prior to the termination of the trust upon giving notice of the proposal to the unit holders and if less than 33-⅓% of the outstanding units filed their dissents in writing, within twenty days from the date of the notice, the sale was to be consummated.

The Trust Agreement which was approved by the Federal Court recited that the "intent" and "purpose" of the Trust was to "liquidate" the trust property and "convert it into cash" and distribute the assets among the beneficiaries, and to that "end" and purpose the Trustee

and the Trust Managers were directed to endeavor to sell the Trust Property as "soon" as it could "advantageously be done" in the opinion of the Trust Managers, and in the meanwhile to conserve it for the benefit of the unit holders. No attempt was made by the respondents to sell and liquidate the premises from 1935 to the date of the filing of the complaint on February 27, 1946 and up to this time. During the eleven years of their tenure of office, two of the Trust Managers secretely purchased trust units through an "agent" at prices ranging from $19 to $51 per unit, and they accumulated over 13% of the outstanding units. No proposal of a sale may be made without the direction of the Trust Managers. By their cooperation with other unit holders to the extent of a total of 33-⅓% of the units, they could prevent a sale and be in a position to prevent any sale and liquidation of the assets prior to the termination of the trust, and thereafter the Trust could be converted into a corporation.

Shortly prior to the filing of the Complaint an offer was made to respondents for the purchase of the Trust Property at the price of $850,000, subject to the submission thereof to the unit holders, and if less than the required number filed their dissents, then the Trust Managers could submit the proposal to other buyers and accept higher bids. The Trust Managers obtained an appraisal that the valuation was $850,000. They decided to submit the $850,000 bid to the beneficiaries with their recommendation that dissents be filed in opposition to the sale and they, themselves, intended to vote their shares in opposition to the sale.

Petitioners, unit holders, filed suit to restrain the respondents (1) from attempting to influence the unit holders to file their dissents, (2) from using their units to dis-

sent, (3) from realizing any profit out of the purchase of these units, and (4) to remove them for their misconduct.

The trial was had in open court, and the trial court dismissed the suit for want of equity. Its decree was reversed on appeal by the Appellate Court of Illinois which held that the respondents were guilty of a breach of trust in acquiring the trust units; that they were not entitled to realize any profit by reason of their breach of trust; that they should be removed from office, and that they had no right to seek to influence the beneficiaries how to vote (*Victor* v. *Hillebrecht,* 339 Ill. App. 254).

In urging a reversal of the decision of the Appellate Court, the respondents said in their brief which they filed in the Supreme Court, that the matters involved in the decision in this case "are of far reaching importance", and that it is "a matter of common knowledge that many reorganization proceedings in the District Court of the United States pursuant to the provisions of §77-B of the Bankruptcy Act have resulted in creating many situations not only similar, but in many respects identical to that herein involved." Petitioners stated in their brief that they were in accord with the statement. The Supreme Court of Illinois reversed the decision and in construing the terms of the Trust Agreement which was created under §77-B, held that the Trust Managers had a right to deal in the securities as a matter of law; that they could not be compelled by any court to liquidate the Trust; that they did not commit a breach of trust; and that they should not be removed.

A Petition for Rehearing was filed which pointed out that it was the duty of the court to follow the Federal law due to the fact that the rights and duties of the Trustee and Trust Managers, as well as the rights of the beneficiaries arose out of the Federal statute, and that the

Federal law was different from the law which the Supreme Court applied. The rehearing, however, was denied.

It is sought by this Petition to obtain a review on the theory that the Federal question was properly raised in these proceedings and is directly involved in the decision of the highest court of the State.

The Questions Involved.

1. Whether Trustees appointed under a Liquidation Trust created under §77-B of the Bankruptcy Act or of its successor, Chapter X of the Bankruptcy Act, may secretly purchase beneficial interests from beneficiaries whereby they place themselves in an adverse position without violating Federal law against dealings by fiduciaries with the subject matter of trust.

2. Whether there is a distinction under Federal law between the purchase of bonds and the purchase of stock or trust units by fiduciaries, and whether the Supreme Court of Illinois was bound by Federal law to affirm the decision of the Intermediate Appellate Court.

3. Whether the purpose of the Liquidation Trust under the plan which was approved by the Federal court was to enable the Trust Managers to acquire the trust assets for themselves to the detriment of the beneficiaries and to realize a handsome profit, or whether it was their duty to preserve the trust property for the trust estate, not to traffic in the securities and to submit the sale of the property to the vote of the beneficiaries without any attempt on their part to influence them as to how they should vote.

4. Whether under the plan of reorganization which was approved by the Federal court the Trust Managers

had the right to purchase units and to vote the units in opposition to a sale, and thereby place themselves in an adverse position against those who desired the sale and liquidation of the premises.

Reasons for the Granting of the Writ.

1. The rights involved arise under a Federal Statute being §77-B of the Bankruptcy Act, as amended, and the Federal question was necessarily involved, and decided by the highest court of the state, and this court has jurisdiction to issue the writ. The reasoning which respondents urged below in support of their argument for the reversal of the judgment is sufficient for the exercise of the discretionary power of this court to issue the writ. Respondents urged there:

> "The matters involved in the decision of this case are of far-reaching importance. It is a matter of common knowledge that the many reorganization proceedings in the District Court of the United States pursuant to the provisions of Section 77-B of the Bankruptcy Act, have resulted in creating many situations not only similar, but in many respects identical, to that here involved."

The reasoning applies with greater force in view of the decision which is contrary to the views of this court in a case where Federal law is controlling.

2. The rights having been created by reason of the Federal statute, it was the duty of the Supreme Court to apply Federal law on the powers and duties and rights of the Trust Managers who were appointed to their office by the Federal Court pursuant to the plan under §77-B of the Bankruptcy Act, and the decision in the instant case is contrary to the decisions of this court concerning the rights, duties and obligations of fiduciaries under that section.

3. The decision of the intermediate Appellate Court was in conformity with the spirit of §77-B as construed by the Federal courts, and the views expressed by the Supreme Court of Illinois are contrary to the construction of that Act by the Federal Courts.

4. The decision makes a radical departure from fundamental unbroken lines of decisions by this court on the conduct of trustees in their relations with beneficiaries and the Trust Property. The implications from the decision will be used as a license for trustees to defeat the very purpose of the trust for which they were appointed, and instead of protecting the rights of the beneficiaries and preserving and conserving the assets for their benefit, they will use it for their personal gain, as by the acquisition of the Trust Units they will acquire the Trust Property, and such a decision deserves to be reviewed by this court.*

Prayer for Relief.

Petitioners pray that this court may grant the Writ of Certiorari to the Supreme Court of Illinois to the end that the judgment may be reversed with directions to affirm the judgment of the Appellate Court of Illinois.

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* The writ should issue for the purpose of obliterating the exceptions invoked by the court tending to justify the dual loyalty. The rule against dual loyalty does not recognize any exceptions as stated in the **Matter of Durston**, 297 N. Y. 64, 71, where the court said: "But we are dealing with the fundamental relationship between a trustee and the beneficiaries of the trust, which we have attempted to define in language which will permit no exception or departure from the rule of fundamental fidelity expressed in **Meinhardt v. Salmon**, 249 N. Y. 458, 464 * * * to obliterate all undivided loyalties which may creep into a fiduciary relationship and utterly destroy with effect by making voidable any transaction in which they appear."

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Respondents.

BRIEF IN SUPPORT OF PETITION.

Jurisdiction Invoked.

The jurisdiction is invoked under §1257 of the Judiciary Act of 1948 (T. 28 U.S.C.A. §1257 (3)).The decision of the Supreme Court of Illinois was rendered on January 18, 1950, and the rehearing was denied on March 20, 1950. The Federal question involved here is the creation of a trust under §77-B of the Bankruptcy Act, as amended, and the rights, powers, duties and obligations of the trustees and beneficiaries thereunder. *

* A copy of the final decree entered in the 77B proceedings containing reservation of jurisdiction for certain purposes appears in the record (Tr. 117-121).

Opinions Below.

The decision of the Intermediate Appellate Court which decided the issues in favor of the Petitioners is not contained in the record, but is fully published (*Victor* v. *Hillebrecht,* 339 Ill. App. 254, 90 N.E. (2) 270). The decision of the Supreme Court of Illinois appears in the record (Tr. 124) and is also officially reported (405 Ill. p. 264, 90 N. E. (2) 751).

A Statement of the Case.

Approval of Plan Under Section 77-B.

Proceedings for reorganization of 7000 South Shore Drive Building Corporation resulted in the adoption and approval by the Federal Court of the Reorganization Plan whereby the holders of the $1,350,000 bonds were given beneficial interests in a Liquidation Trust in exchange for their bonds. Under the Plan each $100 bond received a trust unit and some of the units were issued to other creditors who were given trust units in exchange for their claims. There were issued and outstanding 14,439 Trust Units.

The Trust:

The Trust Agreement (Tr. 14-53) stated that the Trust Agreement was submitted and approved by the Federal Court which designated the Liquidation Trustee, and the Trust Managers. Under the order affirming the plan the Bankruptcy Trustee was authorized to convey to the Trust Company of Chicago, as Trustee under the Liquidation Trust Agreement, the title to all of the assets and property of the Debtor in consideration of the issuance of the beneficial interests to the unit holder. It was provided (Section

2 of Article II) that the "intent" and "purpose" of the plan and of the Liquidation Trust Agreement was "to liquidate" the trust property and convert the same into cash, and to that "end" the Liquidation Trustee and the Trust Manager "shall endeavor to make a sale" as soon as in the opinion of the Trust Managers it can be advantageously done, and to distribute the proceeds among the holders of the participation certificates. It was stated in the next section that it was intended that the agreement create "a true trust."

Article III provided that the Liquidation Trustee shall have the power to sell the trust property prior to the termination of the trust on the directions of the Trust Managers upon giving notice to the holders of the participation certificates, and providing less than 33-⅓% will file their dissents in writing within 20 days.

Article VII provided that the beneficial interest in the net income, proceeds and avails of the Trust Property shall be divided into 14,439 trust units. Under Article IX the liquidation trustee was to submit to the Trust Managers from time to time its report of the amount of distribution from the income, and it could distribute the net income upon the directions of the Trust Managers.

Article X provided that if the Trust Agreement was not terminated sooner, then it shall terminate, in any event, on July 1, 1950, and in the event that the property be not sold prior to the termination date on July 1, 1950, the Liquidation Trustee may cause to be organized a new corporation and shall thereupon not later than December 31, 1950 transfer the property to the new corporation and shall distribute the stock to the holders of the participation certificates in accordance with their then holdings.

The court appointed James B. Bremner, Herbert Hillebrecht and Walter A. Wade as Trust Managers. It provided that in the event of the resignation of any one of the Trust Managers then the court may appoint the successor thereof, and it reserved the power at any time to remove the Liquidation Trustee and the Trust Managers and to appoint their successors. *

Trust Management:

The Trust Managers never advertised the premises for sale and never solicited any bids (Abst. 65). From the date of the creation of the trust in 1935 up to 1945 they never determined at any meeting the amount for which they should sell the trust property (Abst. 64). The trust property is managed by Hillebrecht who occupies an apartment for which he is not paying any rent (Abst. 65). This is in addition to the annual payment to him of $333.33 under the reorganization plan. The Trust Managers never furnished to the certificate holders an operating statement of income and expenses, and only mailed them a statement of the "net" cash proceeds "after operating expenses, rehabilitation and refunds", showing the net balance (Abst. 64-65). The Trust Managers knew that the statements that they were furnishing to the beneficiaries were not "regular" but claimed to have ordered the mailing of "regular" statements and it was the fault of the auditors who prepared the statements without giving the details of the operations. They claimed (Abst. 69) that they asked the auditors to prepare regular statements and they were "supposed" to prepare such statements but they failed to do. However, several beneficiaries objected to the form and one attorney made an objection

*See final decree in the 77B proceedings (Tr. 117-121).

to the form "two years" *prior* to the trial, but the Trust Managers continued to mail the same form of statement as they did in the past (Abst. 66).

The Breach of Trust:

While the purpose of the trust was to "liquidate" the trust property and distribute the proceeds among the beneficiaries, no attempt was ever made to comply with the primary object of the trust, to advertise the property for sale, or to solicit bids (Abst. 64). The Trust Managers never appraised the value of the property to determine at what price they would sell it. During the management of the trust property, they never submitted a statement of income and expenses as is regular and customary in such cases, but merely submitted the *net* income after deducting all operations (Abst. 65-66). This was continued during the ten year period although several protests were received (Abst. 68-69). While they were managing the Trust Estate, had knowledge of the true value, and according to Trust Manager Hillebrecht, the Trust Managers had determined the value at a million and a half (Tr. 96-97), they secretly acquired beneficial interests through the brokerage house, Greenebaum Investment Co., at prices ranging from $19 to $51 per unit (Abst. 61-64). Thus, Trust Manager Hillebrecht, who originally had 35 units, acquired in his own name 1480 units (Abst. 58, 70). Trust Manager Wade, who had no units at all, acquired after he was appointed Trust Manager, 211 units (Tr. 94). The total trust units which they acquired since they became Trust Managers is 1829. No disclosure was ever made to the beneficiaries that these units were purchased through an "agent" for the benefit of the Trust Managers (Abst. 71).

The Trust Managers received the offer of $850,000 in February, 1946. They ordered an appraisal which

showed that the property was valued at $850,000 (Abst. 58). However the Trust Managers "decided it was not sufficient" (Abst. 69) notwithstanding the appraisal which they secured, and notified the Liquidation Trustee to submit the offer with the recommendation to the beneficiaries however, to file dissents (Abst. 54). There was no authority in the Trust Instrument authorizing Trust Managers to influence the certificate holders as to how they should cast their votes (Abst. 54). The Trust Managers intended to use the trust units which they acquired in opposition to any sale (Abst. 68) and "would not even want to submit it at any price" even though they "would not be bound on their approval to sell".

The Decision of the Appellate Court:

Based on these facts the Intermediate Appellate Court held: (1) that the purpose of the trust under the reorganization plan was to liquidate its assets and to distribute the proceeds among the beneficiaries, and was not for the benefit of the Trust Managers, and that they, the Trust Managers, had no right to acquire the trust property for themselves through the acquisition of the trust units, and to place themselves in an adverse position, in that they could, by the acquisition of ⅓ of the trust units or in combination with others, defeat the sale of the trust property and the distribution of the proceeds; (2) that the Trust Managers had no right to seek to influence the beneficiaries how to vote, particularly when they were adversely interested by the acquisition of the Trust Units, and that they were guilty of a breach of trust in acquiring the trust units; (3) that the Trust Managers were not entitled to retain the profit out of the breach of trust, and that they were required to surrender the Trust Units to the Trust Estate upon being reimbursed the funds advanced; and

(4) that they should be removed from office and their successors appointed (339 Ill. App. 254, 90 N.E. (2) 270).

The Decision of the Supreme Court:

The Supreme Court reached the opposite conclusion and held that it was not the primary duty of the Trust Managers to liquidate the Trust Property for the sole benefit of the beneficiaries and that they had a right to acquire the Trust Units and were not guilty of any breach of trust; that although they, themselves, obtained an appraisal that the property was valued at $850,000 and although they received a bid for submission to the unit holders subject to the right to file dissents under the terms of the Trust Agreement, and in the event of the failure to file sufficient dissents, then higher bids might be obtained without further submission to the beneficaries they could not be compelled to submit the offer;* and they were not guilty of a breach of trust and were not subject to removal. It failed to pass on the point whether or not they had the right to seek to influence the beneficiaries as to how they should vote (405 Ill. 264, 90 N. E. (2) 751).

The Petition for Rehearing:

The Petition for Rehearing (Tr. 133-156) pointed out the fundamental error of the court in that the Appellate Court did not direct that the Trust Managers be compelled to submit the offer, as this decision to submit the offer was made by the Trust Managers themselves, but decided that they had to be impartial, and had no right to use their office in seeking to influence the beneficiaries

* The court reached such a conclusion, notwithstanding the fact that the intent and purpose of the liquidation trust was its liquidation and distribution of the proceeds, and the admission of the Trust Managers that they "would not even want to submit" an offer "at any price" (Abst. 68).

to dissent; that the powers and duties of the Trust Managers and the Liquidation Trustee which were created under Section 77-B of the Bankruptcy Act, should be construed under Federal law, and not under State law, and that the Federal law makes no distinction between dealing in bonds or dealing in stock by fiduciaries where they place themselves in an adverse position; and that the opinion of the Supreme Court is not in conformity with the spirit of Section 77-B as construed by the Federal courts. It was also urged that the decision to the effect that the Trust Managers may not be compelled by a court of equity to submit to the beneficiaries the proposal of the liquidation of the Trust Property at the minimum price of $850,000.00, notwithstanding the fact that the Trust Managers themselves obtained an appraisal that the Trust Property was only valued at $850,000.00, and that eleven years had then passed without even an attempt to liquidate the property (during which time the Trust Managers were engaged in buying up the Trust Units for themselves as cheaply as they could), was contrary to the primary purpose of the Trust which was created by the Federal Court pursuant to the plan of reorganization; that the decision that a court of equity may not control the exercise of an arbitrary or unreasonable discretion, is contrary to fundamental Law of Trusts; that the Trust Managers were in no position to exercise a sound discretion because of their adverse interest, and of their admission that they would not want to submit any offer, no matter what the price was, and that such a decision is irreconcilable with the main purpose and object of the liquidation Trust which emerged from the Bankruptcy Court. The Petition was denied by the Supreme Court without any change in its opinion (Tr. 157).

ARGUMENT.

I.

A federal question under Section 77-B of the Bankruptcy Act is clearly involved in this case, and this Court has jurisdiction to issue the writ.

At the threshold of this Petition is the question whether a Federal question is involved in these proceedings. The rights asserted by the Petitioners arise out of the Federal Statute; namely, Section 77-B of the Bankruptcy Act, as amended, and the Federal Statute was set up by the pleadings and was also discussed in the opinions of the Appellate and Supreme Courts.

The Complaint alleged (Abst. 2) that on November 6, 1935 a Liquidation Trust was created pursuant to a plan of reorganization which was approved by the United States District Court for the Northern District of Illinois. A copy of the Liquidation Trust Agreement was made part of the Complaint (Abst. 4; ¶ 8) as Exhibit "A". It alleged that the Trust Agreement recited that on March 22, 1935, a plan of reorganization was prepared and approved by the District Court under §77-B, and that the court directed preparation of a Liquidation Trust Agreement for the court's examination and approval, and that the Liquidation Trust Agreement was so prepared and approved by the court. After stating the terms of the Trust, which the court approved and that the rights of the Petitioners grew out of the Trust created by the Federal court, the Complaint alleged the failure of the Trustee and Trust Managers to carry out its primary object "to liquidate", and instead of preserving the Trust Estate for the beneficiaries until liquidation,

the Trust Managers *secretly* acquired trust units at prices below their real value for their personal gain and profit; and that during the ten years in office, they never attempted to liquidate the property. It also alleged that an offer was submitted to respondents for the purchase of the property at the price of $850,000 subject to the right of the beneficiaries to dissent under the terms of the Trust, and in the event of the failure to dissent, then they could solicit higher bids and sell it to the highest bidder. The Trust Managers intended to submit the offer but to advise the beneficiaries to vote *against* the sale, to prevent the liquidation, to remain in office, and to enable them to further acquire trust units and ultimately acquire the Trust Property. It sought to hold them liable for their misconduct, to have them disgorge the profits which they made out of the purchase of the trust units, and to remove them for their misconduct (Abst. 3-10).

The Appellate Court held that the allegations were supported by the proof and that Petitioners were entitled to the relief and directed the trial court to enter a decree finding the Trust Managers guilty of a breach of trust; that they be directed to surrender the trust units to the Trust upon being reimbursed the amount which they invested; that they be restrained from attempting to influence the beneficiaries how to vote on the proposed sale, and that they be removed from office and that their successors be appointed (339 Ill. App. 254).

The Supreme Court of Illinois reached the opposite conclusion and reversed the judgment of the Appellate Court. It was pointed out in the original brief as well as in the Petition for Rehearing that the Federal law under §77-B prohibits fiduciaries from dealing directly or indirectly with the subject matter of the Trust; that the Appellate Court in rendering its decision followed

the Federal law. The Supreme Court of Illinois reversed the decision and cited as authority a case decided by the Tennessee court in 1873. The decision of the Supreme Court of Illinois, therefore, *directly involves the construction of a Federal Statute,* being §77-B of the Bankruptcy Act under which the Trust was created.

In *Swope* v. *Leffingwell,* 105 U. S. 3, a suit to restrain a sale of real estate given to secure a note to a national bank was dismissed by the State court, and this court held that the suit involved a Federal question because the right was that of a national bank which was created under Federal law. This was followed in *Oeau Claire National Bank,* 204 U. S. 522, 532.

In *St. Louis, I. MT. & S. Ry. Co.* v. *Starbird,* 243, U. S. 592, this court discussed the right to issue the writ of certiorari when the suit involved a Federal Statute. At page 598 the court said:

> "The federal right *is not required to be pleaded in any special or particular form.* It is enough that it be relied upon and in a proper manner called to the attention of the court. Section 237 of the Judicial Code does not require that the statute creating the federal right shall be especially set up. The courts take judicial notice of the statute. *It is the right,* privilege or immunity of *federal origin* which must be brought to the attention of the state court."

The court further said (p. 599):

> "In *Ferris* v. *Frohman,* 223 U. S. 424, it appears that the complainant asserted a copyright in a certain play under the common law and defendant set up the copyright or the play, the performance of which was issued under the laws of the United States. The state court enjoined the defendant from using that copyright, and it was held that was sufficient to show that a federal right had been set up and denied, as

the copyright of the defendant was derived under the federal law. That the controversy raised a federal question was held by this court and the contrary contention disposed of in the following language:

'The defendants in error contest the jurisdiction of this court upon the ground that the bill was based entirely upon a common-law right of property, and insist that the upholding of this right by the state court raises no Federal question. *But the complainants sued,* not simply to maintain their common-law right in the original play, but by virtue of it to prevent the defendant from producing the adapted play which he had copyrighted *under the laws of the United States.* They challenged a right which the copyright, if sustainable, secured. R. S. 4952. It was necessary for them to make the challange, for they could not succeed unless this right were denied. *Ferris* stood upon the copyright. That it had been obtained was alleged in the bill, was averred in the answer; and was found by the court. *The fact that the court reached its conclusion in favor of the complainants, by a consideration, on common-law principles,* of their property in the original play *does not alter the effect of the decision.* By the decree *Ferris* was permanently enjoined 'from in any manner using, * * * selling, producing, or performing * * * the said defendant's copyrighted play hereinbefore referred to for any purpose.' *The decision thus denied to him a Federal right* specially set up and claimed within the meaning of §709 of the Revised Statutes of the United tSates. This court, therefore has jurisdiction."

It also said (p. 601):

"The other requisite essential to bring the case within §237 of the Judicial Code is that the alleged federal right must be denied. *It has never been required that a federal right must be denied in terms, but it has been uniformly held that it is sufficient if*

the state court necessarily denied it in the judgment rendered. If the plaintiff, in bringing this suit to recover against the initial carrier, not only for its own negligence but for that of the intervening carriers in the failure to care for and deliver the several cars of peaches, had said in terms that the suit was thus brought upon a through bill of lading because of the federal statute giving the right to thus prosecute the action, no one would doubt that the federal question was brought to the attention of the state court; when the plaintiff set forth facts which necessarily showed that a suit could only be maintained because of rights given under the Carmack Amendment, upon a bill of lading required by that act, *it was unnecessary to further label the cause of action by specific reference to the federal statute. Jones National Bank* v. *Yates,* 240 U. S. 541, 550, 551. So, when the defendant set up the breach of the through bill of lading, and insisted that it had not been complied with, he would have made his case no stronger for the purposes of review here had specific reference been made to the federal statute which made this bill of lading the sole rule of obligation between the parties.

This court concluded:

"This record presented a suit which showed that it was necessarily brought under rights conferred by a federal act; the defendant specifically pleaded the failure to keep the obligation of the contract whose force was binding by virtue of such act; and the state court, in stating in its decision that this bill of lading had been issued, and would be controlling in the absence of special facts which it found as to the effect of verbal notice given to certain agents of the Pennsylvania Company in New York, *necessarily denied the contention of federal right made by the defendant* that the provision of the bill of lading was conclusive of the rights of the parties in this case and required written notice within thir-

ty-six hours after notice to the consignee of the delivery of the goods.

For these reasons the case is properly reviewable here." (Emphasis ours).

In *Seabury Receiver* v. *Greene,* 294 U. S. 165, it was urged that no Federal question was involved and in reaching the opposite conclusion, this court said (p. 168):

> "The court's ruling that the Estate is not liable for the amount necessarily depends upon its construction of §66. The judgment is reviewable under §237-B, Judiciary Code."

The rule was followed in *Frost & Co.* v. *Mines Corp.,* 312 U. S. 38, 40, where the court cited *Awotin* v. *Atlas Exchange National Bank,* 295 U.S. 209, 213, and held that a state court decision involving the interpretation of a Federal Statute presented a federal question for review.

In the instant case, the Petition for Rehearing pointed out to the Supreme Court that *its views were contrary to the Federal law,* and that the rights claimed here arise under the Federal statute. The Petition said (Tr. 151):

> "The court pointed out that the Trust Managers were appointed by the Federal Court under the Federal law of reorganizations under Section 77-B of the Amendment to the Bankruptcy law. *Having been appointed under a Federal law, the spirit of the Federal law should rather be applied than that of the Tennessee court which this court relies on.* The Federal law makes no distinction between the acquisition of a claim or the purchase of stock from stockholders by those who stand in a fiduciary relation. The authorities are collected in *Re Mountain State Power Co.,* 118 F (2) 405."

The Petition also urged:

> "Having assumed a fiduciary relationship under a trust agreement which was created by virtue of the reorganization proceedings it was their duty to conform to the standards of conduct which the law im-

posed upon them and which made no distinction between purchase of claims and purchase of stock (*Smolowitz* v. *Delendo Co.*, 136 F (2) 231, 239).

It is clear that the Federal law and not the State law is controlling where the right arises out of the Federal Statute (*Solo Electric Co.* v. *Jefferson Co.*, 317 U. S. 173, 177; *Prudence Corporation* v. *Giest*, 316 U. S. 89, 95).

While the question of "timely" raising the Federal question is not involved because it was raised from the *inception*, yet it should not be overlooked that the Petition for Rehearing raised this question as a result of the unexpected decision of the Supreme Court of Illinois, and the Federal question was, therefore, also raised pursuant to the rule pronounced in *Sanders* v. *Shaw*, 244 U. S. 317, 320; *Brickerhoff-Farris Co.* v. *Hill*, 281 U. S. 673, 677; *Wilson* v. *Cooke*, 327 U. S. 474, 485.

II.

The decision of the Supreme Court of Illinois is in conflict with federal law on the rights, duties and obligations of fiduciaries appointed under Section 77-B of the Bankruptcy Act.

Not only is the decision in the instant case contrary to the *fundamental law of trusts* as to the rights and obligations of trustees in their relation with their beneficiaries, but it is also *contrary to the Federal decisions* under §77-B and Chapter X of the Bankruptcy Act in construing the rights and duties of fiduciaries.

(a) Fiduciaries may not deal in the securities of a reorganized company under § 77-B or Chapter X of the Bankruptcy Act, and the sanctioning of the acts of the trustees in the instant case is contrary to Federal law which is controlling under the Liquidation Trust which was created by the Federal Court.

We have shown above that the Liquidation Trust was created by the Federal court pursuant to the plan of reorganization under §77-B. The first mortgage bondholders were compelled pursuant to that section at the will of 2/3 of them, to exchange their first mortgage bonds for the trust units issued under the Trust Agreement. The trust managers and the liquidation trustee were appointed by the Federal court to *liquidate* the property during a fifteen-year period, and if no liquidation was possible during that period, they could create a corporation and exchange the trust units for stock in the corporation. This was a long program of reorganization, and the court reserved jurisdiction during the period to remove the Trust Managers and the Trustee and to appoint their successors.* The Trust Managers were, therefore, *acting under the reorganization plan which was created under the Federal statute.*

(1) The Trust Managers acquired their interest in the Trust Property in fraud and breach of trust as held by the Appellate Court, and the views of the Supreme Court to the contrary are not in conformity with the views of the Federal courts.

The purchase of the trust certificates by the Trust Managers was fraudulent and clearly a breach of trust. The Trust Managers were placed in their trust duties under a reorganization plan which was approved by the Bankruptcy Court in a reorganization proceeding under Section 77-B. The first mortgage bond issue

*See final decree entered in the 77B Proceedings (Tr. 117-121).

which was placed on the building when it was erected was in the amount of $1,350,000 (Tr. 68-69). These bonds were exchanged for trust certificates in the ratio of one unit for each $100 bond and there were issued 14.439 trust units (Abst. 5, 35).

If the testimony of Trust Manager Hillebrecht is true, that the trustees "determined the value of the building" when they "placed the insurance of $1,550,000" (Tr. 65-66)) then they estimated its value in excess of the value of the certificates, so that *each certificate was at least worth* $100. The Trust Managers commenced purchasing the units at the rate of $19 *for each* $100 (Abst. 61). The unit holders who sold the certificates were *not* informed that the certificates were acquired for the *undisclosed principals,* the Trust Managers.

Realizing the delicacy of his position, Trust Manager Hillebrecht testified on direct examination of his counsel that Greenebaum Investment Co. *solicited him* to purchase the securities, giving the impression that after Greenebaum Investment Co. acquired the certificates it resold them to him (Abst. 70). A mere inspection of the exhibits (Abst. 61-65) will demonstrate the *falsity* of his testimony. If Greenebaums had previously acquired the securities for themselves, then they would have made an outright sale to the Trust Managers and realized whatever profit they would have made. The witness however, had forgotten his previous testimony on cross-examination under Section 60 (Abst. 60) wherein he testified: "Greenebaum Investment Co. *acted as my broker.* Mr. Berlin was the person with whom I dealt and I believe *they received a commission for the sale.*" Such testimony is *irreconcilable* with his testimony that the Greenebaum Investment Co. solicited him from time

to time after it acquired the securities from the beneficiaries.

Trust Manager Hillebrecht attempted to convince the court that he did not act for his own benefit but acted for the benefit of the beneficiaries when he purchased the securities. He said (Abst. 70):

> "I purchased some certificates above the market. I paid $51.50. The market at that time was between $39 and $40."

At this stage the court was somewhat curious to know why Trust Manager Hillebrecht would purchase securities at $51.50 when the market was not above $40 and the following transpired:

> The Court: "What was the object of buying them at a higher price than at the market?"
>
> The Witness: "To protect the trust from the pressure groups on the outside. I mean, who wanted to get control to force a sale at a certain price and I bought some of them to get them away from the pressure groups."

The appellate court commented on the evidence, saying:

> "It would be naive, indeed, to ascribe to Hillebrecht and his cotrustee the altruism they claim in purchasing these certificates—to prevent others from acquiring control. Their conduct can be interpreted only as a course of speculation in securities of the trust for their own advantage and, when they embarked on such a course, they did so to create for themselves an interest in the trust, which was patently adverse to the interests of the beneficiaries generally, many of whom undoubtedly desired that the trust property be sold at a fair price and at a relatively early date. Furthermore, by voting his trust units against the $850,000 offer, as he testified he would, Hillebrecht would necessarily compete with the beneficiaries who favored the acceptance of such offer."

In this connection it is interesting to read his answer on cross examination. He said (Tr. 70-71):

> "At the time I paid $51 per share, the market quotation was $39 per share, *but none were available and I paid $51 per share because there were none available below that price.* No one was competing with me at that time.
>
> Q. So you didn't pay $51 per share in order to keep out other buyers?
>
> A. This was a block. *It was a block of shares that I bought and it is better to buy a block of shares than isolated shares.* A block of shares at $51 was quoted. *I paid that price because that is the price the party wanted.* I tried to buy it for less but they wouldn't sell it." (Emphasis ours.)

That the Trust Managers were not interested to carry out the object of the trust to *liquidate* the property and to *distribute* its assets and were only interested to *retain their control until* they could *acquire the major part of the trust units* appears clearly from the testimony of Hillebrecht who said (Abst. 68):

> "If there was a price of $850,000 submitted without any condition, just to find out how the bondholders felt, the trust managers would not even want to submit it at any price at this time, even though we would not be bound on their approval to sell."

This was in the face of the express provision in the trust agreement that the object was to *sell* and dispose of the trust property, and in the face of the *appraisal* which the Trust Managers, themselves procured, appraising the property at $850,000.

The acquisition of the securities was not only procured by fraud, but it placed the Trust Managers in an *adverse* and *competing* position with the beneficiaries who desired that the trust property be sold at a fair price.

The Trust Managers *knew the real value of the Trust Estate.* If they had furnished to the beneficiaries the "regular" statement of income and expenses and capital improvements, *they might have had an idea as to the true value of their certificates.* In order to keep the beneficiaries in the *dark* and to enable their "agent" to acquire the certificates for the Trust Managers at *nominal* prices, they *never* furnished the beneficiaries such a statement as is usual and customary in the management of similar trusts. Hillebrecht was asked why the Trust Managers did not furnish the unit holders a proper statement of operations and in reply he stated (Abst. 70) that "the statements were prepared by John E. Burke & Company, certified public accountants" and he "did not give them any instructions how to prepare the statements". He said: "We asked them to make up the *regular* statements that were *supposed* to be made and these were made." By this answer he either attempted to blame the certified public accountants for *not* submitting the proper statements or to imply that he did not realize that this was not a regular statement. However, he later *admitted* that "one or two of the unit holders—one was an attorney—made an objection I believe two years ago". This objection *placed them on notice* that the information furnished the unit holders was irregular, yet *they continued the practice,* as is evident from exhibits 6 and 7 (Abst. 67) which were mailed *thereafter.* By this method the Trust Managers *concealed* the real value of the Trust Estate and *acquired* the large block of securities through Greenebaum Sons Investment Co., their *agent* (Abst. 61-65), for as low a price as they could get them (Abst. 70-71).

The trust units which the Trust Managers thus acquired through their "agent", *without disclosing that*

they were the real buyers, was clearly in breach of trust (54 Am. Jur., Trusts, § 361; Bogert on Trusts, ¶ 493).

(b) The Appellate Court properly followed Federal law when it held that the Trust Managers were guilty of a breach of trust in dealing with the subject matter of the Trust for their personal gain whereby they placed themselves in a conflicting position, and the reversal of its judgment by the Supreme Court of Illinois is in conflict with the views of this court.

The Appellate Court discussed the authorities on which respondents relied and in discussing such authorities, it said (339 Ill. App. 254, 265):

> "These cases involved the right of directors to purchase the stock of their corporation and hold in effect that, since the business and property of a corporation are entrusted to its officers and they are empowered to act for the whole body of stockholders, they therefore occupy the position of trustees for the stockholders as a body in respect to such business and property and cannot have or acquire any personal or pecuniary interest in conflict with their duty as such trustees; that there is no trust relationship between a director of a corporation and an individual stockholder with respect to the latter's stock, over which the director has no control whatever; and that, therefore, he may deal with an individual stockholder and purchase his stock practically on the same terms as a stranger. It is the lack of a trust relationship between them that permits directors to purchase the stock of a corporation from its shareholders. The rule enunciated in the foregoing cases is not applicable to an express trust, where the relation of trustee and *cestui que* trust exists. The trust instrument in the case at bar expressly provides that "the agreement creates a true trust" (section 3, article II) and another provision of the instrument (section 2, article

> XIV) charges the trust managers with the specific duty of liquidating the trust property for the benefit of the certificate holders, thereby making them trustees for the individual beneficiaries."*

The Appellate Court discussed the contention that the trust units were akin to shares of a business trust or a Massachusetts Trust, and it cited the authorities (p. 266, 267) which distinguished a liquidation trust from a business trust.

In reversing the judgment of the Appellate Court the Supreme Court said (405 Ill. 264, 271):

> "True, the purchasing defendants, if the property is eventually sold for more than the bid, **will stand to profit handsomely by the sale**. However questionable the practice of bidding in these certificates on the market by the trustee may be, we think these plaintiffs are in no position to complain because they have not been hurt and any gain accruing to the defendants, Hillebrecht and Wade, will likewise proportionately accrue to plaintiffs."**

The Supreme Court completely lost sight of the view of the Appellate Court which pointed out how the plaintiffs were hurt when it said (339 Ill. App. 254, 267):

> "Defendants insist that if there was impropriety in any purchase of a certificate, the seller is the only one who can complain. They readily admit that a trustee cannot purchase in his own name and for

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*This is in conformity with the rule announced by this court that "when such an investigation discloses the existence of unfair dealing, a breach of fiduciary obligations, profiteering from a trust, special benefit for the reorganizers or the need of protection of investors against an inside few, * * * the court has ample power to adjust the remedy to meet the need. (American Ins. Co. v. Avan Park, 311 U. S. 138, 146; Re Midland United Co., 159 F. (2) 340, 344).

**This is contrary to fundamental law of trusts and to the construction of such law by the federal courts. No principle of the law of trusts is more settled than that a trustee will not be allowed to profit out of his administration of a trust "even though there is no loss to the estate and no wrong is intended by the trustee" (Buder v. Fiske, 174 F. (2) 260, 282, citing Magruder v. Drury, 235 U. S. 106, 119; Woods v. City National Bank & Trust Co., 312 U. S. 262, 269).

his own benefit an outstanding judgment lien, squatter's right in the trust property, etc., and that, if he does so, the trust is entitled to the benefit thereof upon reimbursing the trustee for his outlays in connection with such a purchase, but they say that this rule has never been applied to the purchase by a trustee of a beneficial interest from a beneficiary. By specious reasoning defendants argue that since the trustee has the right to purchase for himself the interest of a beneficiary and that such a purchase can be set aside only for fraud, 'it seems to us axiomatic that the only one who can complain of the fraud is the person defrauded.' *There is no force to this argument in view of the obvious fact that the rights of the holders of trust units who did not sell same to Hillebrecht and Wade, were also affected by the conduct of the trust managers,* as will be hereinafter shown. The cases cited by defendants, which hold that conveyances in fraud of creditors can be set aside only by creditors who are defrauded, are not applicable. The question as to whether the trust managers were guilty of fraud as to the holders of trust units, who sold them to Hillebrecht and Wade, is of no consequence in this proceeding. *The question here concerns rather the propriety of the purchase by the trust managers of beneficial interests in a trust, which was created for the benefit and advantage of the beneficiaries generally,* in whom was vested the right to accept or reject an offer to purchase the trust property upon its submission to them by the trust managers." (Emphasis ours).

The plaintiffs and the other certificate holders will also be hurt because on July 1, 1950, the Trust will expire and under its terms the Trust Certificates may be exchanged for stock in a new corporation which respondents may organize. The Trust Managers who had accumulated until 1946 over 13% of the Trust Units and are now in control of the Trust, will control the corporation and

the holders of the Trust Units will be forced to sell them on the market at prices which the Trust Managers will maintain as they did in the past.

In disposing adversely to the contention that due to the fact that the Trust Managers did not own 33-⅓%, they could not prevent the liquidation, the Appellate Court said (339 Ill. App. 254, 269):

> The fact that the trust managers had not acquired the one-third interest in the trust necessary to block any offer that might be submitted for the purchase of the trust property is not of crucial importance, **because their ownership of more than one-tenth of the trust units could easily lead to the formation of a group strong enough to reject any offer made,** however advantageous it might be considered by the remaining certificate holders.
>
> Even though it be assumed that the trust managers did not stand in a fiduciary relationship in respect to the trust units when they purchased them, their ownership of same gave them a substantial interest in the trust, which might readily tempt them to neglect the interests of the beneficiaries generally.

After citing the Illinois law, it discussed the Federal law, and cited the early decision of this court on this subject saying (p. 270):

> "In the early case of *Michaud* v. *Girod,* 4 Howard 503, 11 L. Ed. 1076, the court said: 'There is no blinking the fact that the ground on which the court denounces as a fraud the purchase by a trustee of trust property is that it inevitably brings about a conflict of interest between himself personally and the beneficiaries of his trust; or at least incites a motive, or affords opportunity for a motive, on the part of the trustee to take advantage of his superior knowledge acquired in his trust capacity, which may induce him to conceal his information from the beneficiaries or

not to employ it exclusively for the benefit while they are relying on him scrupulously to devote himself to the furtherance of their welfare.' "

The Court also said:

"In *Wootten* v. *Wootten*, 151 F. (2) 147, the court said (p. 150):

"A trustee must not compete with his beneficiary in the acquisition of property. The principle is not limited to cases where the fiduciary acquires property entrusted to him, nor to cases where the fiduciary competes with the beneficiary in the purchase of property which the trustee has undertaken to purchase for the beneficiary. *Even though the interest purchased by the fiduciary for himself is not property of the beneficiary entrusted to the fiduciary, nor property which the fiduciary has undertaken to purchase for the beneficiary, the principle applies if the property purchased by the fiduciary for himself is so connected with the trust property or the scope of his duties as fiduciary, that it is improper for him to purchase it for himself.*" (Italics Appellate Court).

The Supreme Court of Illinois reached the opposite conclusion. After stating the "universally recognized and "unbending rule" that a trustee may not acquire an interest in a trust, it said that there are *exceptions* to the rule, one of which is that a trustee may purchase trust property for his own benefit "where the trustee could not have any control over the sale." This rule has no application here as *the control of the sale is completely vested in the Trust Managers.* This is particularly true under the decision in the instant case, for even if 99% of the holders of the outstanding units should desire the liquidation of the Trust Property, no such sale could be had without its submission to the vote of the unit holders, and *no submission can be had if the Trust Managers should merely say that they are of the opinion that no sale should*

be had. Under this decision, no matter how *arbitrarily* the Trust Managers should act, a court of equity would be *powerless* to compel them to submit the question of the sale to the beneficiaries.

Having complete control of the submission of any offer and having 13% of the units they in combination with additional units may prevent any sale as pointed out in the opinion of the Appellate Court, they thereby had the "control of the sale", and the "exception" to the rule is inapplicable.

The Supreme Court adopted the *narrow view* of the Tennessee court in *Brown* v. *Cooper,* 62 Ten. 153 (1873) which distinguished a purchase of a claim by a trustee from the purchase of a beneficial interest. Even in that case the purchase was *qualified* "when done in good faith, without fraud or imposition", and in announcing the rule and its *limitations* the Court said (p. 156):

> "The rule is well stated in Perry on Trusts, Sec. 428, that a trustee may purchase of a *cestui que trust,* or accept a benefit from him, but the transaction must be *beyond suspicion,* and the *burden is on the trustee to vindicate the bargain* or gift from any shade of suspicion, and *to show* that the transaction was *perfectly fair and reasonable* in every respect. • • • In the present case, the *beneficiaries are satisfied with their bargain and make no objection* to the receipt by the trustee of the full amount of their claims assigned to him. *Nor do the other beneficiaries of the 6th class dispute the validity* of the assignment; on the contrary, they claim the benefit of the profits made by the purchaser, and for that reason, do not attack it."

In the instant case *the other beneficiaries are assailing the purchase* because it directly affects their interest in that the Trust Managers will use the certificates in order

to make up the 33-⅓% to *defeat* the liquidation of the property. They are, therefore, parties in interest as distinguished from the interest of the persons who assailed the purchase in the *Brown* case, *supra,* whose interest was *"subordinate"* to that of the outstanding certificates.

Instead of following this *narrow* view of the Tennessee court, the court should have followed the views expressed in *Wootten* v. *Wootten,* 151 F. (2) 167 which was relied on by the Appellate Court (pp. 271, 273) and which is in line with the *modern trend of the law.* Even the Tennessee courts have extended the rule in *McNeal* v. *Dobson-Bainbridge Realty Co.,* 184 Tenn. 99, 195 S. W. (2) 626. There, the court pointed out that a trustee "will not be allowed to mix up his own interests and affairs with those of the beneficiaries." It said (p. 629) that this doctrine has its foundation not so much in the commission of actual fraud, but "in that profound knowledge of the human heart, which dictated that hallowed petition, 'lead us not into temptation, but deliver us from evil,' and that caused the announcement of the *infallible* truth, that *'a man cannot serve two masters."* There, the court also said that the *fairness or unfairness* of the transaction or the absence of actual fraud *are not permitted to enter into the consideration* but that it is enough that "the relation of trustee and *cestui que trust* existed." It is founded on the origin of the creation by equity of constructive trusts to remove from fiduciary relationships the *temptation* to take advantage of personal gain. The doctrine is not based on the idea that the transaction is necessarily an injury to or a fraud upon the principal, but *"on the idea of closing the door to temptation to fraud".* The principle is one of "prevention" and not "remedial justice".

The Supreme Court pointed out (405 Ill. 264, 272) that the Trust Managers were appointed by the Federal Court

under the Federal law of reorganizations under Section 77-B of the Amendment to the Bankruptcy law. Having been appointed under a Federal law, the spirit of the Federal law should rather be applied than that of the Tennessee court which the court relies on. The Federal law makes no distinction between the acquisition of a claim or the purchase of stock from stockholders by those who stand in a fiduciary relation.

In *Smolowe* v. *Delendo Corporation*, 136 F 2d. 231, the court said (p. 235):

> "We look first to the *background* of the statute. *Prior* to the passage of the Securities Exchange Act, speculation by insiders—directors, officers, and principal stockholders—in the securities of their corporation *was a widely condemned evil.*"[1]

The court further said (p. 239):

> "Recovery runs not to the stockholder, but to the corporation. We must suppose that the statute was intended to be thoroughgoing, *to squeeze all possible profits out of stock transactions*, and thus to establish a standard so high as to prevent any conflict between the selfish interest of a fiduciary officer, director, or stockholder and the faithful performance of his duty. Cf. *Woods* v. *City Nat. Bank & Trust Co. of Chicago*, 312 U. S. 262, 61 S. Ct. 493, 85 L. Ed. 820; *In re Mountain States Power Co.*, 3 Cir., 118 F 2d. 405; *Otis & Co.* v. *Insurance Bldg. Corp.*, 1 Cir., 110 F 2d 333; *In re Republic Gas Corp.*, D.C.S.D.N.Y., 35 F. Supp. 300."

The court also said (p. 239):

> "First, the statute as interpreted does not infringe due process guaranties. It was enacted only upon a considered finding, supported by ample evidence, of

[1] See Hearings before Committee on Banking and Currency on S. 84, 72d Cong., 2d Sess., and S. 56 and S. 97, 73d Cong., 1st and 2d Sess., 1934; Tracy and Mac Chesney, The Securities Exchange Act of 1934, 32 Mich. L. Rev. 1025, 1032; Comment, 32 Mich. L. Rev. 678.

> *a new approach* to the common-law attitude *which* the abuses of inside speculation. *In effect it was but had long recognized the reasonableness of enforcing a level of conduct upon fiduciaries* 'higher than that trodden by the crowd.' See *Meinhard* v. *Salmon*, 249 N.Y. 458, 464, 164 N.E. 545, 546, 62 A.L. R. 1." (Emphasis ours).

The distinction between dealing in "claims" or "bonds" and dealing in "shares" or "trust units" which is the foundation for the decision of the Supreme Court reversing the judgment of the Appellate Court, *is not in conformity with the Federal law* which knows of no such distinction. This court said in *Securities and Exchange Commission* v. *Federal Water & Gas Co.*, 332 U. S. 194, (at page 208):

> "The purchase by a holding company management of that company's securities during the course of a reorganization may well be thought to be so fraught with danger as to warrant a denial of the benefits and profits accruing to the management. The possibility that such a stock purchase program will result in detriment to the public investors is not a fanciful one. The influence that program may have upon the important decisions to be made by the management during reorganization is not inconsequential. Since the officers and directors occupy fiduciary positions during this period, their actions are to be held to a higher standard than that imposed upon the general investing public. There is thus a reasonable basis for a judgment that *the benefits and profits accruing to the management from the stock purchases* should be prohibited, regardless of good faith involved."

While that case applies to purchase during reorganization, the principle applies to the purchase by management during liquidation, which is but another form of reorganization.

In relying on the decision of this Court in the *Mitchaud* case, *supra*, as applicable to the purchase of stock by a fiduciary in *Hughes* v. *S.E.C.*, 174 F (2) 969, and in answer to the point that the case was "readily distinguishable" the court said (p. 975):

> "However, neither its age nor its distinguishability can detract from the force and vigor of the general doctrine set out there."

In *Buder* v. *Fiske*, 174 F (2) 260, the court said (p. 282):

> "No principle in the law of trusts is more settled than that a trustee will not be allowed to profit out of his administration of a trust, even when there is no loss to the Estate and no wrong is intended by the trustee."

citing prior decisions of this court. The fiduciary relationship of the Federal Liquidators in the instant case was not any different from Federal receivers where certiorari was obtained "to determine certain important questions concerning the proper administration of Federal reorganizations." (*Cities Inc.* v. *Prudential Co.*, 322 U. S. 408). There, this court said (p. 414):

> "The court, as well as all the interested parties, had the right to expect that its officers would not make undisclosed private agreements, fail to reveal any pertinent information or use their official position for their own profit or to further the interests of themselves or any associates."

The rule announced in the *Mitchaud* case was applied to the purchase of stock by fiduciaries appointed under §77-B *in re Mountain State Power Co.*, 118 F. (2) 405, 407, where the court cites the authorities construing that section.

In *United States* v. *Carter*, 217 U. S. 286, the court stated (p. 306) that the "nature of the relation" is "of

paramount importance"; that the rule is of "universal application"; that no one standing in a trust relation may enter into engagements "which possibly may conflict with the interest of those he is bound to protect."

The rule which prohibits adverse dealings by fiduciaries in *stock* was adopted by other courts and their reasoning is apropos here.

In *City Bank Farmers Trust Co.* v. *Cannon,* 291 N. Y. 125 the rule was applied to a Trustee which acquired stock *individually* while it also held stock as *trustee,* and in holding that this was a breach of trust, the court said that "The standard of loyalty in the trust relation" did *not* warrant the trustee to place itself in the dual relation." It concluded that in purchasing the stock the trustee *"had conflicting interests to serve in deciding to sell or not to sell"* the shares belonging to the trust. This is in accord with the views expressed in the opinion in the instant case. This rule was followed in *Matter of Durston,* 297 N.Y. 64, where it was contended that the broad powers contained in the trust agreement authorized the trustees to deal in the securities. In holding adversely to the contention the court said, (page 71):

> "There is much force in this argument and if we were dealing with a simple contract it would perhaps prevail. *But we are here dealing with the fundamental relationship between a trustee and the beneficiaries of the trust, which we have attempted to define in language which will permit no exception or departure from the rule* of fundamental fidelity expressed in (*City Bank Farmers Trust Co.* v. *Cannon,* 291 N.Y. 125, 131)—is firmly entrenched in our law."

In the *Matter of Lewisohn,* 294 N.Y. 596, the court said:

> "Enough has now been said to show why that investment is denounced by the trust beneficaries as

> a breach by the trustee of the duty of undivided loyalty which it owed to the interests that were committed to its care in its office as committee of Mr. Lewisohn. A true discharge of that duty called upon the trustee completely to avoid all occasions for the counteraction of incompatible demands. This stringent measure of trust administration is not one of mere integrity or unselfishness. The rule is inflexible that a trustee shall not place himself in a position where his interest is or may be in conflict with his duty (*Ten Eyck* v. *Craig, et al.*, 62 N.Y. 406, 419; *Albright* v. *Jefferson County Nat. Bank*, 292 N.Y. 31). * * * We do not see how the trustee was to stand between such divided allegiances without being subjected—in the persons of its managing officers—to the temptation to be false to its trust. The law permits no trustee to act in such inconsistent relations and this trustee should in consequence be surcharged (*Wendt* v. *Fischer*, 243 N.Y. 439; *City Bank Farmers Trust Co.* v. *Cannon*, 291 N.Y. 125; *Matter of Ryan*, 291 N.Y. 376)."

The rule that a trustee may not deal in trust certificates which adversely affect the beneficiaries makes no distinction between the *trust res*, and the certificates held by the beneficiaries. This was recognized in *Siegleman* v. *Steinberg*, 5 Cal. (2) 674, 56 P. (2) 202. There, Siegleman owned individually one-third of the stock and he owned one-third *in trust* as guardian for a ward. He used his position, controlling two-thirds of the stock, to oust from management the owner of the remaining third of the stock. By these means he compelled such owner to purchase the one third of the stock which was beneficially owned by Siegelman *individually*. It was there contended that he did not deal with the *trust res* as he sold his own stock and retained the stock for his ward. In holding that the "deal" was in breach of trust the court said (p. 203):

"The only showing necessary to justify the finding of judgment and which was made, was that the guardian dealt with the trust property for his own financial gain."

The Court also said:

"The Court was justified on the facts presented in concluding that the guardian could not in good conscience retain the fruits of the transaction procured through the use by the guardian of the ward's stock, the retention of which would be beneficial to the guardian and a great financial loss to the ward."

The same principle is applicable here to the "purchase" instead of a "sale" of the certificates which adversely affects the interests of the *cestui.*

In Bogert on Trusts and Trustees, §485, the author says:

"If the trustee makes himself co-owner with the trust he automatically gives room for possible conflict and dispute. As an individual he may desire to improve the property, but the beneficiaries of the trust may object. In all the problems of management there may arise occasions when a decision in one way would be good for him personally, but another solution would be more advantageous to the trust. Equity should prevent the danger to the trust which may come from this type of co-ownership."

He also says:

"If the fiduciary buys up for himself such adverse or *competing interest* in the same property in which his trust exists, he must hold it subject to the trust, if the *cestui* so demands and tenders the price which the trustee had paid." (Emphasis ours.)

Professor Bogert further said:

"In many cases it will be the duty of the fiduciary to buy this competing interest for his prin-

> cipal, so that buying it for himself will be a breach of trust in *two* senses, namely, a violation of his duty to buy for his beneficiary and a violation of his duty not to introduce selfish interests into his dealing." (Emphasis ours.)

In *Morris* v. *The Broadview, Inc.*, 328 Ill. App. 267, the court said (273):

> "In support of his contention plaintiff cites a number of cases holding, in the absence of authority granted in the trust agreement, that a trustee is not permitted to deal in the subject matter of the trust. *This rule is generally acknowledged.*"

This related to "Trust Units" *identical* with those involved here. The only reason the court sanctioned the "dealing" by the Trust Managers was because of the *express provision* in that agreement that they may "purchase" or "deal" in the trust units. This provision is lacking here.

The Supreme Court clearly erred when it said in its opinion:

> "It is highly significant in the case at bar, that the plaintiffs are not the beneficiaries who have sold the units upon the open market." and "No one has come forward here who has sold his or her certificates."

The persons who sold their trust units could *not have come forward* in this suit as the interest of those who sold their certificates is *not* in the same class with that of the plaintiffs who did not sell their certificates. Plaintiffs seek relief for the benefit of those who *did not sell* the certificates to obtain a cancellation of the trust certificates which the Trust Managers acquired, and the relief of those who sold their certificates to reacquire them for themselves on the ground of *rescission* would be *adverse* to that of the plaintiffs. It would have been improper to *join* them as

parties-plaintiffs (*Rottenberg* v. *Seifried,* 322 Ill. App. p. 701; *Hackner* v. *Morgan,* 117 F (2) p. 95). The rights of the individual persons who sold their shares *could not be joined* in a class suit as their rights are *separate* and *distinct,* and it would have been too expensive for each individual to commence such a suit. *There was no way for any one of those who sold their certificates to have "come forward here",* and it would have been *improper* to go out of the record on the question whether or not persons who sold their certificates had commenced any action for rescission or fraud. Besides, the persons who sold their certificates may not be aware that they sold their certificates to the trust managers as they purchased them through an intermediary. At any rate, the relief which the plaintiffs sought was of a *different* nature and *they* were adversely affected by the purchase, as the trust managers could use the units which they acquired to defeat any sale.

III.

The determination in the instant case, contrary to the opinion of the intermediate Appellate Court, that Respondents were not bound to submit the offer to the beneficiaries, notwithstanding the fact that they, themselves, obtained the appraisal that the value of the Trust Property did not exceed the amount of the bid, constitutes a denial of the rights of the beneficiaries under the Federal Statute.

We have shown above that the Liquidation Trust was created under §77-B; that the "intent" and "purpose" was to "liquidate" the Trust Property and distribute the proceeds. The Trust was created in 1935 and will expire in July, 1950. If no sale will be held prior to that date, no liquidation may be had, as thereafter the Trust Units may be exchanged for stock in a new corporation.

An offer of $850,000 was made with the right to solicit higher bids if less than 33 1/3% will file dissents. The Trust Managers themselves obtained an appraisal stating the value of the Trust Property to be the amount of the bid, in the sum of $850,000. In the face of such a record it is indeed difficult to understand the statement in the opinion of the Supreme Court that (405 Ill. 264, 272):

> "To date an adequate price, in their opinion, has not been offered nor has the value of the property recovered to an extent which would warrant a submission of the matter of sale to a vote. In this their opinion may be quite correct.* We hold they were not bound to submit any bid under this showing and the court cannot compel the trustees to exercise a discretion given to them by the express terms of the agreement."

The "opinion" under the Trust, which was created by the Federal Court, was not to be an arbitrary one.

It is true as said by the Supreme Court that:

> "The defendants were selected by the Federal Court for the purpose of exercising their judgment and best opinion in the matter of the sale of this property."

However, the "judgment" was to be a *sound* judgment and the "opinion" was to be the *best* opinion, and the intent was to carry out the main objective. The court overlooked that the *primary purpose was the liquidation of the trust* and the *distribution of the assets.* It was provided in Article II (Abst. 19) that the "intent" and "purpose" of the reorganization plan and of the liquidation

* This conclusion was made in the face of the statement of the Chancellor that "He would take judicial notice," that the properties of this nature had a better market now than ever before, and of the admission of the Trust Managers that they would not even submit an offer of any price (Abst. 68).

trust was *"to liquidate the Trust Property"*, to "convert it into cash", and to *distribute the* assets to the advantage of the participation certificate holders. It was *to that "end"* that the Liquidation Trustee and the Trust Managers were *to endeavor to sell"* or dispose of the property *"as soon"* as in the "opinion" of the Trust Managers it could be done "advantageously". This "opinion" was not to be an arbitrary one. Here is a case where the trust managers *made no attempt* for fourteen years to carry out the main purposes for which they were appointed; namely to liquidate the trust property and took no steps at any time to even determine for themselves the true value of the property and did not even order an appraisal prior to the submission of the bid of $850,000.

The statement of the Court that to date an adequate price, in the Trust Managers' opinion, "has not been offered," is contrary to the record if the "opinion" referred to is the "sound opinion." The said opinion can only be ascertained from the fact that the Trust Managers themselves obtained an appraisal that the $850,000 bid was a fair price for the property (Abst. 58; Par. 17). The "opinion" of the Trust Managers was that it should not be sold at all. Trust Manager Hillebrecht said (Abst. 68):

> "If there was a price of $850,000 submitted without any conditions, just to find out how the bondholders felt, the Trust Managers would not want to submit it at any price at this time, even though we would not be bound on their approval to sell."

The Appellate Court after quoting this evidence properly said (399 Ill. App. 254, 268):

> "This testimony indicates the determined opposition of the trust managers not only to the $850,000 offer but to any higher offer that might have been made at that time and it affords a reasonable explanation

for such opposition and for the willingness of Hillebrecht and Wade to invest upwards of $40,000 of their own funds in acquiring large blocks of trust certificates. If permitted to continue their acquisition of trust units, they could purchase enough certificates themselves or in combination with others to attain sufficient voting strength to block any bid made and thus defeat the wishes of the holders of as many as two-thirds of the trust units who might desire to sell the property, until such time as the trust managers considered it advantageous to themselves to liquidate the trust."

The Supreme Court also overlooked that the issue of discretion was not involved, as the Trust Managers themselves decided to submit the offer (Abst. 58; Par. 17) and the relief which Petitioners sought and which the Appellate Court granted was to prevent them from attempting to influence the unit holders to file dissents as will be shown later.

While the issue of discretion in so far as it relates to the submission of the offer was not involved and the only issue that was involved was whether the Trust Managers had the right to influence the holders of the trust units to file their dissents, the decision in the instant case which gives a license to the Trust Managers not to submit any bid even when the bid equals the valuation of the property and that all that the trustees need to say is that they are of the opinion that it should not be submitted, is contrary to the very purpose of the Trust Agreement which was created by the Federal court. It is contrary to an unbroken line of decisions that a court of equity may interfere with the exercise of a discretion when it is arbitrary and unreasonable (*Brown* v. *McLanahan*, 148 F 2d. 703, 707). A discretion lodged in a trustee is rarely, if ever, a permit to act arbitrarily. Usually,

such a grant of discretion is confiined to the exercise of judgment not unreasonable in the light of the purposes of the trust and of the circumstances in which it is sought to be exercised. A court of equity has power to control the administration of a trust so that it will accord with the purposes of the creators of the trust (*Rollin* v. *Halvering*, 92 F (2) 390, 393; *Stix* v. *Commissioner*, 152 F (2) 562, 563). This is also the Illinois law as construed by this court in *Halvering* v. *Stewart*, 317 U. S. 154, 165; *First Nat'l Bank* v. *Bryn Mawr Bldg. Corporation*, 365 Ill. 409, 430.

Considering the fact that the Trust Managers had the mandate from the Federal court to liquidate the Trust as soon as it was advantageous to the beneficiaries, and that instead of liquidating it they liquidated the interest of some of the beneficiaries when they acquired their trust units for themselves below their real value and that they made no attempt to liquidate it during almost fourteen years; that they received an offer for the purchase of the property equal to the amount of the valuation with the further privilege of soliciting higher bids in the event of the failure to dissent by the required number of units, the decision of the Supreme Court of Illinois that the Trust Managers need not submit it and they could thereby wait until July 1, 1950 when the Trust will expire and then organize a corporation and exchange the trust units for stock, *violates the intent and purpose of the trust which was created under the Federal Statute.*

The Supreme Court entirely misconceived that **the issue of discretion was not involved nor decided by the Appellate Court.**

The Complaint did *not ask that the court compel the* Trust Managers to submit the offer or *to exercise any*

discretion in submitting the offer. On the *contrary*, it alleged (Abst. 7; Par. 17) that the Trust Managers *had exercised* their discretion to submit the offer of $850,000 after they received an appraisal that this was the fair value of the property and merely sought to prevent sending a communication with the submission which was intended to influence the beneficiaries to file dissents. This allegation was admitted in the answer (Abst. 58; ¶17).

The *primary* relief which it sought was to *prevent* the Trust Managers *from influencing* the beneficiaries to file dissents (Abst. 12). The Appellate Court did *not* decide that the Trustees should submit the offer but decided that the submission of the offer be *without any attempt* by the Trust Managers *to influence* the beneficiaries to file dissents. It said in its opinion that it is *fundamental* that Trustees should include in the submission of an offer all necessary information in order that the beneficiaries may determine for themselves whether or not to approve or reject the sale, and they should *not* seek to *influence* the vote but should be *impartial*, particularly when they themselves are interested by virtue of the acquisition of beneficial interests therein. The Appellate Court said (p. 262):

> "the offer must be submitted *without any attempt* on the part of the trust managers *to influence the beneficiaries for or against its acceptance*, except as they might be influenced by the relevant facts, and that it is for the beneficiaries to draw their own conclusions from such facts as to whether the offer should be approved or disapproved. (*Shapiro* v. *Chicago Title & Trust Co.*, 328 Ill. App. 650; *Gaver* v. *Gaver*, 176 Md. 171, 4 A (2d) 132, 138; *Adams* v. *Cowen*, 177 U. S. 471, 483). To hold otherwise would defeat the very purpose and intent of the trust agreement to allow the beneficiaries to make their own

> decision on the acceptance or rejection of an offer, *uninfluenced by the desires of the trust managers.*" (Emphasis ours)

That there was *no question of discretion* involved appears from the proof. Trust Manager Hillebrecht was asked (Supp. Abst. 22):

> "Now, when the offer of $850,000 was made to the trustees, *the trustees instructed* the Trust Company of Chicago *to submit* an offer but the trustees stated that *they would recommend that the trust certificate holders shall dissent* from the sale, is that correct?" (Emphasis ours)

and Hillebrecht answered:

> *"That is right, that is the way it was left".*

It is, therefore, *clear* that the Trust Managers *had exercised their discretion* to submit the offer, and the *only* question for determination was whether they had a right to "influence" the beneficiaries to file their dissents. *This is the only question which the Appellate Court had before it and which it decided,* but the Supreme Court *erroneously assumed* that the question involved was whether or not the Trust Managers should exercise the discretion to submit the offer.*

The decision in the instant case (based on the erroneous assumption of the facts as shown above) that Trust Managers who were appointed for the primary purpose "to liquidate the Trust Property" (Abst. 5) and who made *no attempt* to carry out the object of the liquidation for over *eleven* years and who obtained an offer of $850,000 with the right to receive higher bids, need not submit the offer, in the face of their own appraisal that the property was only worth $850,000, *is fraught with danger* and is poisonous in its consequences, affecting the many trusts

*This error was pointed out in the Petition for Rehearing (Tr. 135-139).

which emerged from the bankruptcy courts. The only excuse necessary for Trust Managers not to carry out the main purpose of liquidation, is for them to say that they are of the "opinion" that it should not be liquidated. *What Trust Manager will say that he is of the opinion that the Trust Property should be liquidated* if by such liquidation his *job* would be at an *end,* and he would be in no position to acquire additional securities for his personal gain during the continued existence of the trust? The answer is obvious.

The Appellate Court gave due consideration to the issues presented. It reached a *unanimous* decision after holding the matter under advisement for *three years,* and rendered an *exhaustive* opinion supported by a *wealth* of authorities, (339 Ill. App. 254, 90 N. E. (2) 270). It is significant that *not one word is mentioned in the opinion* of the Supreme Court concerning the views expressed by the Intermediate Appellate Court. We have already shown that it even misconceived the issues that were involved there. The primary relief which plaintiffs sought and which the Appellate Court held that the Chancellor should have granted, was the submission of the bid to the beneficiaries *without any attempt by the respondents to influence the beneficiaries how to vote.* The Appellate Court stated in its opinion concerning the primary relief which was sought and to which Petitioners were entitled, that (p. 263):

> "The principal purpose of this suit was to restrain the trust managers from wrongfully attempting to influence the certificate holders to vote to reject the $850,000 offer and to compel them to submit the offer without any recommendation. The trust managers were strongly opposed to the acceptance of the offer. The only reason they condescended to submit it at all to the beneficiaries was because they knew that

they would have been derelict in their duty as trustees, if they failed to submit it, after having procured an appraisal themselves from the Chicago Real Estate Board, showing that the value of the property was $850,000."

The Appellate Court properly concluded (p. 263):

"Plaintiffs, having been compelled to seek the aid of a court of equity to frustrate the wrongful intention of the trust managers to recommend the rejection of the offer, certainly should not have been denied the relief sought in this regard, after they had established their right to it."

It is clear that Petitioners were entitled to the relief under the fundamental principles of equity, and that the Supreme Court of Illinois misconceived the issues involved, the principal point decided by the Intermediate Appellate Court, and the main purpose of the trust which was created by the Federal Court. The holding in the instant case that respondents who were appointed by the Federal Court to *liquidate* the Trust Property as *soon* as it could advantageously be done and who failed to carry out the main object from 1935 to this date, may not be compelled by a court of equity to submit a proposal for the sale and liquidation of the property at not less than the value at which they appraised it, with the right to even receive higher bids, and as long as the respondents in their trust capacity will say that they are of the "opinion" that the property should not be sold, no submission should be made, is contrary to the very purpose of the creation of the "Liquidation Trust".

In their argument to the Supreme Court of Illinois to obtain a reversal of the decision of the Intermediate Appellate Court respondents stressed the point that the trust created in the foregoing proceedings *was one of the many*

trusts that were created by the Federal courts under §77-B and Chapter X of the Bankruptcy Act, and that the decision in the instant case will affect all these trusts. This reasoning is applicable for the exercise of the discretionary power of this court for the allowance of the writ to review this decision before it becomes final, and which will be used as a *license* by trustees to defeat the very purpose for which they were apopinted, and to acquire the trust assets for themselves.* Such a decision should no to be permitted to remain as the law as it will affect the many trusts that emerged from the Federal Courts.

Conclusion.

It appears from the foregoing that a Federal question is directly involved in these proceedings and that the Federal question was decided by the highest court of the State not in comformity with the Federal law, which is controlling on the Federal question. It also appears that the views expressed by the highest court of the State are contrary to the fundamental law of trusts and that the decision of the Appellate Court of Illinois was in conformity with the general law of trusts and with the views expressed by this court. The trust involved is one of the many trusts which were created by Federal courts under Section 77-B as well as by its successor, Chapter X of the Bankruptcy Act.

*By the acquisition of the trust units, the Trust Managers would acquire the Trust Property. If the Trust Managers may not purchase for themselves the Trust Property, it must follow as a matter of law that they cannot purchase the trust units, whereby they would accomplish indirectly that which they could not do directly.

The writ of certiorari should, therefore, be issued under the discretionary powers of this court to review the foregoing decision.

Respectfully submitted,

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